

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
RYKG, INC.	:	DETERMINATION
for Revision a Determination or for Refund of Sales and	:	DTA NOS. 819983
Use Taxes under Articles 28 and 29 of the Tax Law for	:	AND 819984
the Period September 1, 1998 through May 31, 2001.	:	

In the Matter of the Petition	:
of	:
HOWARD FRANK	:
for Revision a Determination or for Refund of Sales and	:
Use Taxes under Articles 28 and 29 of the Tax Law for	:
the Period September 1, 1998 through May 31, 2001.	:

Petitioner RYKG, Inc., 6 Spinnacker Court, Fort Salonga, New York 11768, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1998 through May 31, 2001.

Petitioner Howard Frank, 6 Spinnacker Court, Fort Salonga, New York 11768, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1998 through May 31, 2001.

A consolidated hearing was held before Winifred M. Maloney, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on February 16, 2005 at 10:30 A.M., with all briefs to be submitted by July 14, 2005, which date began the six-month period for the issuance of this determination. Petitioners appeared by

Kestenbaun & Mark (Bernard S. Mark, Esq., of counsel) and Karen J. Tenenbaum, P.C. (Karen J. Tenenbaum, Esq., of counsel). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Lori P. Antolick, Esq., of counsel).

ISSUES

I. Whether the audit method employed by the Division of Taxation was reasonable or whether petitioners have shown error in either the audit method or result.

II. Whether penalties imposed pursuant to Tax Law § 1145(a)(1)(i) and (vi) should be sustained.

FINDINGS OF FACT

1. After graduating in 1984 from Fairleigh Dickinson University with a degree in marketing, petitioner Howard Frank worked in retail stores, delis and pizza places. Then, for a number of years, he owned a deli in Westbury, New York, which he sold sometime prior to June 1994. On or about June 10, 1994, petitioner RYKG, Inc. ("RYKG" or "the corporation"), the S corporation owned equally by Mr. Frank and his wife, Pamela Frank, purchased a "going" fast food concession that operated a shopping mall fast food snack stand. Mr. Frank was president of RYKG.

2. RYKG operated this fast food snack stand in the Sunrise Mall, a two-level shopping mall containing three anchor stores and a total of approximately 150 stores, located in Massapequa, on Long Island, New York. The snack stand operated under the name "Snnnacks" or "Snacks" ("Snnnacks"). The stand, a free-standing kiosk, was located on the lower level of the mall in the middle of an open area near the entrance to Macy's. The kiosk was equipped with running water and a sink located behind the counter, as well as storage space for the food and beverage items available for sale. The 700-square-foot kiosk was surrounded by tables and

chairs, belonging to Snnacks, that seated approximately 20 people. During the period in issue, Sunrise Mall was open for business Monday through Saturday from 10:00 A.M. until 9:30 P.M. and on Sundays from 11:00 A.M. until 6:00 P.M. Snnacks was open during the mall business hours.

3. Prior to the audit period, in addition to Snnacks, a number of businesses, including a Roy Rogers Restaurant, a Nathan's and the Sunrise Deli, sold food and beverages in the Sunrise Mall. Over time, however, some of these businesses closed. On December 31, 1998, the Roy Rogers Restaurant, located on the lower level of the mall near Snnacks, closed. On or about April 5, 1999, Nathan's, located in the middle of the mall, closed. On or about January 30, 2000, the Sunrise Deli, located on the upper level in the middle of the mall, closed.

4. During the period at issue, RYKG reported the following taxable sales:

Sales tax quarter ended	Taxable sales reported
Nov. 30, 1998 ("Nov-98")	\$21,438.00
Feb. 28, 1999 ("Feb-99")	18,365.00
May 31, 1999 ("May-99")	16,988.00
Aug. 31, 1999 ("Aug-99")	15,340.00
Nov. 30, 1999 ("Nov-99")	20,322.00
Feb. 29, 2000 ("Feb-00")	18,111.00
May 31, 2000 ("May-00")	20,671.00
Aug. 31, 2000 ("Aug-00")	16,085.00
Nov. 30, 2000 ("Nov-00")	22,624.00
Feb. 28, 2001 ("Feb-01")	18,562.00
May 31, 2001 ("May-01")	21,220.00
Total taxable sales reported	\$209,726.00

It is noted that, with the exception of the quarter ending February 29, 2000, the amount reported as gross sales by the corporation on its sales and use tax returns filed for the audit period was the same as the amount reported as taxable sales on those returns.

5. On the U.S. Income Tax Return for an S Corporation (Form 1120S) that it filed for each of the years 1998 through 2002, RYKG reported its sales and gross profit as follows.

Year	Gross receipts or sales	Cost of goods sold	Gross profit
1998	\$174,820.00	\$35,629.00	\$139,191.00
1999	\$141,761.00	\$30,202.00	\$111,559.00
2000	\$142,341.00	\$33,437.00	\$108,904.00
2001	\$97,688.00	\$23,966.00	\$73,722.00
2002	\$178,195.00	\$25,740.00	\$152,455.00

On the Federal corporate income tax returns that RYKG filed for the years 1998 through 2002, merchandise purchases in the amounts of \$29,168.00, \$32,605.00, \$34,680.00, \$15,320.00 and \$12,308.00, respectively, were reported.

6. On or about August 1, 2001, the Division of Taxation assigned an auditor, Brian McCann, to conduct a sales tax field audit of RYKG for the period September 1, 1998 through May 31, 2001. The audit of RYKG originated because the gross sales reported on its sales tax returns were significantly less than the sales that were reported on its Federal income tax returns.

7. A review of the Tax Field Audit Record ("audit log") indicates that, on September 5, 2001, the auditor contacted the corporation by telephone concerning the commencement of the sales tax field audit and spoke with Mr. Frank who referred the auditor to the corporation's representative, Ivan Goldstein, a certified public accountant. Further review of the audit log for that date indicates that the auditor was informed by Mr. Frank that the corporation operated a

snack stand in the Sunrise Mall, which sold, among other things, hot dogs, pretzels and beverages.

8. An appointment letter dated September 10, 2001 advising that a sales tax field audit would commence on a date to be scheduled between the auditor and the taxpayer's representative was sent by the auditor to RYKG, Inc. c/o Ivan Goldstein. The letter requested that the corporation make available all of its books and records pertaining to its tax liability for the period under audit, September 1, 1998 through May 31, 2001, including journals, ledgers, sales invoices, purchase invoices, cash register tapes, Federal income tax returns and exemption certificates. Attached to the letter was a checklist of records to be presented for audit. The checklist restated the items listed in the letter and requested the following additional records: general ledger, cash receipts journal, cash disbursement journal, merchandise purchase invoices, expense purchase invoices, fixed asset purchase invoices, guest checks, financial statements, a power of attorney, bank statements, canceled checks and deposit slips.

9. On October 19, 2001, Mr. McCann received a packet of materials from Mr. Goldstein. The packet consisted of copies of the corporation's sales tax returns for the audit period, monthly bank statements for the entire audit period and a two-page summary of alleged product purchase information listing a total of eight products and suppliers, their alleged respective dollar amounts and the alleged total product purchase amounts for the audit period. According to these two pages, total alleged product purchases amounted to \$10,215.00 for the period September 1, 1998 through December 31, 1998; \$21,786.00 for the year 1999; \$21,370.00 for the year 2000 and \$6,066.00 for the period January 1, 2001 through May 31, 2001.

10. On October 25, 2001, the auditor initiated a telephone conversation with Mr. Goldstein during which they discussed the packet of documents previously supplied to the

auditor and the auditor requested copies of the corporation's Federal income tax returns. During that telephone conversation, Mr. Goldstein informed the auditor that the taxpayer did not maintain a sales or cash receipts journal, cash register tapes or a day book. Rather, the taxpayer maintained "weekly or semi-weekly totals" on a computer with no backup. According to Mr. Goldstein, the products and dollar amounts listed on the two sheets were taken from purchase invoices and the purchases were paid for, at least in part, by cash from the cash registers.

11. On October 31, 2001, the auditor received copies of the corporation's Federal income tax returns for the years 1998 through 2000 from the representative. A reconciliation performed by the auditor indicated that the sales reported on the corporation's Federal income tax returns were higher than the sales reported on the corporation's sales tax returns. The auditor's review of the monthly bank statements indicated that the bank deposits had no correlation to sales.

12. Although a written request was made for all of the corporation's books and records pertaining to its sales and use tax liability for the audit period, the auditor did not receive any general ledgers, sales journals, day books, cash register tapes, guest checks, merchandise purchase invoices or expense purchase invoices for the audit period from the corporation's representative. After reviewing the records provided by the corporation, the auditor determined that these records were inadequate to determine the amount of Snnacks' taxable sales.

13. On February 15, 2002, the auditor requested that a lunchtime field survey of Snnacks be conducted by a Nassau District Office investigative aide. On or about March 6, 2002, investigative aide Lorin Kanton conducted a field survey of Snnacks. During his field survey, Mr. Kanton made notes and diagrammed the area surrounding the snack stand, specifically identifying the following stores located nearby: Macy's, Nine West, Sterling Optical and The Limited. The auditor reviewed the notes and diagram with Mr. Kanton.

14. The Division decided to conduct a one-day observation test of Snnacks to calculate the corporation's sales tax liability. By separate letters dated April 5, 2002, the auditor notified both Mr. Goldstein and Mr. Frank of the Division's decision to conduct an unannounced one-day observation of Snnacks within the next six weeks. The audit log indicates that Mr. Goldstein responded by telephone on April 8, 2002, stating that he wanted to know the exact date on which the observation of Snnacks would take place. It further indicates that the auditor informed Mr. Goldstein that the observation would take place within six weeks of April 5, 2002; however, the exact date could not be disclosed to Mr. Goldstein. The audit log also indicates that Mr. Goldstein strongly opposed the proposed unannounced observation. Mr. Goldstein did not suggest an alternate course of action to be taken to determine the corporation's sales tax liability.

15. After conferring with his team leader and section heads, the auditor selected Friday, April 26, 2002 as the date on which to conduct a one-day observation test of Snnacks. On April 23, 2002, in preparation for the unannounced one-day observation test, Mr. McCann did an initial field visit to Snnacks and noted in his audit log that the snack stand sold, among other things, sandwiches, soda, juice, iced tea, candy, hot dogs, hamburgers, popcorn and coffee. He also noted that the prices of blackboard special sandwiches ranged from \$4.75 to \$5.75 with an included small soda.

16. An unannounced one-day observation test was conducted at Snnacks on April 26, 2002 by Mr. McCann and two other auditors from 10:20 A.M. until 9:30 P.M. when the mall closed. Before beginning their observation of Snnacks, the auditors contacted mall security and management and explained why they were present in the mall on that date. Then, the auditors went down to the concession stand, identified themselves to the employees working at Snnacks and commenced the observation at 10:20 A.M. Shortly thereafter, one of the employees called

Mr. Frank at the Broadway Mall and he came to Snnacks for a brief period of time in the afternoon. After the introductions, no further conversations took place between the auditors and either any of Snnacks' employees or Mr. Frank during the remainder of the day.

17. The Massapequa and Farmingdale areas experienced rain, heavy at times, and gusting winds on Thursday, April 25, 2002. However, Friday, April 26, 2002, the date of the observation, was a regular seasonal day with no significant weather characteristics.

18. During the observation test, Mr. McCann observed three employees working at the Snnacks kiosk at all times. He also observed that the night manager replaced the day manager at 5:00 P.M. Using the menu board displayed within the kiosk, customers would place their orders at the kiosk counter. Two cash registers were located within the kiosk, one on each end of the counter. At times during the observation test, the auditors observed sales being simultaneously rung up on the cash registers. During the observation test, Mr. McCann noted that a muffin delivery was made to Snnacks and paid for in cash. Mr. McCann also observed that there was a McDonald's located within the mall, as well as a concession selling pizza. Additionally, he observed that a food court was being constructed at the opposite end of the mall (from Snnacks) on the upper level.

19. On the date of the observation test, Mr. McCann did not see a printed menu price list, only a menu board displayed within the snack stand. Neither Mr. Frank nor any of Snnacks' employees working that day supplied Mr. McCann with a printed menu. During the course of the audit, the corporation did not provide Mr. McCann with any printed menus listing the sales prices of the food and beverage items available for sale at Snnacks during the period September 1, 1998 through May 31, 2001. No cash register tapes were provided to the auditor for either the audit period or the date of the observation test.

20. In his observation worksheet notes, Mr. McCann identified some of the items sold by Snnacks, along with their respective prices. A review of his observation notes indicates that, on the date of the observation test, Snnacks had three “Lunch Specials (Blackboard),” i.e., tuna salad, chicken salad and egg salad, that included a small drink in the price. Mr. McCann further noted that Snnacks sold, among other items, bottled water, hot popcorn and hot pretzels. His observation notes also identified the following “possible nontaxable” items for sale (if not consumed on Snnacks’ premises): a muffin, small chips, small cake, fruit salad by the pound, Nesquick chocolate milk, Snapple iced tea, a plain roll and Tropicana orange juice.

21. One of the auditors also recorded the prices of food and beverage items available for sale at Snnacks from its menu board on the back of her first observation worksheet. A review of her notes concerning that menu board price list indicates that Snnacks sold, among other things, hamburgers (with or without cheese), hot dogs, potato and spinach knishes, pretzels, popcorn, breakfast sandwiches, assorted sandwiches, chili, three sandwich “specials,” soup, coffee, hot chocolate, soda and fresh fruit salad ($\frac{1}{2}$ lb. and 1 lb. sizes). The auditor noted that the menu board price list also included chips, candies, orange juice and chocolate milk.

22. Although Snnacks had a small number of nontaxable items available for sale, Mr. McCann noted that it sold “very, very little” of these items on the day of the observation. He observed that when one of these nontaxable items was purchased, the customer sat down at a table to consume the item, therefore making the item taxable.

23. The record includes a total of eight observation worksheet pages on which the auditors recorded RYKG’s sales that they observed between 10:20 A.M. and 9:30 P.M. on the date of the observation test, April 26, 2002, as well as notes about the snack stand, the items available for sale and the observation itself. During the observation test, the auditors did not record each

taxable item sold. Rather, on the observation worksheets, the auditors itemized, on an hourly basis, the total taxable amount, if any, of each sale based on what they saw being sold and rung up on the registers by the employees, as well what the auditors heard the employees tell the customers was due. If a customer's order included the purchase of a Snapple iced tea for off-premises consumption, the cost of the Snapple was deducted from the total amount due and only the taxable amount of the sale was recorded on the observation worksheets. In instances where a customer's order included the purchase of a bag of chips for off-premises consumption, the auditors deducted the cost of the chips from the total amount due and recorded only the taxable amount of the sale on the observation worksheets.

24. Based upon the observation test results, Mr. McCann computed total taxable sales for April 26, 2002 to be \$1,219.15. To determine the taxable sales for the quarter ending May 31, 2001, the auditor multiplied the \$1,219.15 by 91 days¹ to arrive at \$110,942.66. Since the observation test took place in April 2002 and the audit period ended on May 31, 2001, the auditor used the Bureau of Labor Statistics Data Consumer Price Index for food and beverages to adjust the quarterly taxable sales for inflation. After determining the rate of inflation for food and beverages between March 2001 and March 2002 to be 2.5%,² the auditor reduced the quarterly taxable sales of \$110,942.66 by 2.5%, or \$2,705.92³ and determined audited taxable sales for the quarter ending May 31, 2001 to be \$108,236.73. From the \$108,236.73 in audited taxable sales for the quarter ending May 31, 2001, the auditor subtracted reported taxable sales

¹ The auditor subtracted 1 day for Easter from the 92 days in the quarter and arrived at 91 days.

² To determine the inflation rate of 2.5%, the auditor divided the Consumer Price Index ("CPI") for March 2002, 176.6, by the CPI for March 2001, 172.2 (176.6/172.2 equals 1.025 or 2.5%).

³ To allow for inflation, the auditor first divided \$110,942.65 by 1.025 and arrived at \$108,236.73. Then, he subtracted \$108,236.73 from \$110,942.65, the taxable sales for the quarter ending May 31, 2002, to arrive at an allowance for inflation of \$2,705.92.

for the quarter ending May 31, 2001 of \$21,220.00 and determined audited additional taxable sales for the quarter ending May 31, 2001 to be \$87,016.73 (\$108,236.73 less \$21,220.00 equals \$87,016.73). To arrive at an error rate on reported sales of 410.07%, the auditor divided \$87,016.73, the additional audited taxable sales for the quarter ending May 31, 2001, by \$21,220.00, the reported taxable sales for the quarter ending May 31, 2001 (\$87,016.73 divided by \$21,220.00 equals 4.10069 rounded to 4.1007 or 410.07%). Then, the auditor multiplied the 410.07% error rate by the amount of taxable sales reported for the audit period and determined additional taxable sales in the amount of \$860,023.42 for the period September 1, 1998 through May 31, 2001. He then multiplied the additional taxable sales determined to be due for the audit period by the sales tax rate of 8.5% to arrive at additional sales tax due for the period September 1, 1998 through May 31, 2001 in the amount of \$73,101.99.

25. A Statement of Proposed Audit Change for Sales and Use Tax (form AU-346) was issued to RYKG on May 2, 2002 that proposed additional tax due in the amount of \$73,101.99, plus penalties and interest. The proposed penalties on the statement were computed pursuant to Tax Law § 1145(a)(1)(i) and (vi). A review of the audit log indicates that the auditor mailed the pertinent work papers and the statement to the corporation's representative.

26. Mr. Goldstein disagreed with the proposed audit change and filed a complaint against the Division. However, the corporation's representative canceled two scheduled conferences to discuss the audit findings.

27. Dennis Adelman was appointed as the corporation's representative on or about November 15, 2002. On November 22, 2002, the auditor, his team leader and Mr. Adelman had a conference at which the audit findings and the basis of the audit findings were discussed.

28. As a result of the conference and his audit experience, Mr. McCann revised his audit computations of the additional tax liability as follows. To determine the taxable sales for the quarter ending May 31, 2001, Mr. McCann divided the \$1,219.15 in total taxable sales observed on April 26, 2002 by 0.1612, the estimated ratio of Friday's sales to total weekly sales,⁴ to arrive at estimated weekly sales of \$7,562.97. Then, the auditor multiplied the estimated weekly sales of \$7,562.97 by the 13 weeks in the quarter to arrive at estimated quarterly taxable sales of \$98,318.61. Next, using the 2.5% inflation rate, the auditor reduced the estimated quarterly taxable sales by \$2,398.01⁵ and determined audited taxable sales for the quarter ending May 31, 2001 to be \$95,920.60. From the \$95,920.60 in audited taxable sales for the quarter ending May 31, 2001, the auditor subtracted reported taxable sales for the quarter ending May 31, 2001 of \$21,220.00 and determined audited additional taxable sales for the quarter ending May 31, 2001 to be \$74,700.60 (\$95,920.60 less \$21,220.00 equals \$74,700.60). To arrive at an error rate on reported sales of 352.03%, the auditor divided \$74,700.60, the additional audited taxable sales for the quarter ending May 31, 2001, by \$21,220.00, the reported taxable sales for the quarter ending May 31, 2001 (\$74,700.60 divided by \$21,220.00 equals 3.52029 rounded to 3.5203 or 352.03%). Then, the auditor multiplied the 352.03% error rate by the amount of taxable sales for the audit period and determined additional taxable sales in the amount of \$738,298.45 for the period September 1, 1998 through May 31, 2001. He then multiplied the additional taxable sales

⁴ To give weight to Friday being a busy sales day for Snnacks, the auditor examined the sales from a prior audit of a similar fast food business, located at the Broadway Mall in Hicksville, New York, that he had conducted in May 2001. Based on his review of the information from that prior audit, Mr. McCann determined the estimated ratio of Friday's sales to total weekly sales to be 0.1612.

⁵ The auditor divided \$98,318.61 by 1.025 and arrived at \$95,920.60. Then, he subtracted \$2,398.01 from estimated taxable sales for the quarter of \$98,318.61 to arrive at an allowance for inflation of \$2,398.01.

determined to be due for the audit period by the sales tax rate of 8.5% to arrive at additional sales tax due for the period September 1, 1998 through May 31, 2001 in the amount of \$62,755.37.

29. On December 10, 2002, the Division issued two statements of proposed audit change to RYKG reflecting the auditor's revised computation of additional sales tax liability. The first statement proposed additional tax due in the amount of \$56,405.80, plus penalties and interest, for the period September 1, 1998 through February 28, 2001. The second statement proposed additional tax due in the amount of \$6,349.57, plus penalties and interest, for the period March 1, 2001 through May 31, 2001. On the same date, the Division also issued to RYKG an amnesty application for the Statement of Proposed Audit Change for the period September 1, 1998 through February 28, 2001. The audit log indicates that, on December 10, 2002, the auditor gave all the information to Mr. Adelman who was in the District Office on an unrelated matter.

30. After his receipt of the work papers and the two statements of proposed audit change, Mr. Adelman did not provide the auditor with any documentation pertaining to either the corporation's daily sales activity for the audit period or the auditor's estimate of these sales at any time prior to the issuance of the Notice of Determination. The audit log entry for January 10, 2003 indicates that, during a telephone conversation, Mr. Adelman informed the auditor that it was his belief that the corporation wanted to go through with amnesty; however, it was a matter of whether the payment could be made. A subsequent entry for January 23, 2003 indicates that Mr. Adelman called the auditor and, during that conversation, requested that the penalty be waived solely on the basis that it was the taxpayer's first audit. During that same telephone conversation, the auditor told Mr. Adelman that the vendor did not demonstrate reasonable cause and, then, transferred the phone call to the team leader's telephone number where the representative left a message. Subsequently, on January 28, 2003, while in the District

Office on an unrelated matter, Mr. Adelman spoke with the auditor's team leader and explained that he was waiting to hear from the taxpayer (Mr. Frank). The audit log indicates that on March 7, 2003, the auditor spoke twice with Mr. Adelman by telephone and, during both conversations, Mr. Adelman stated that the taxpayer had informed him that he had filled out and filed the amnesty papers. Further review of the audit log reveals that the auditor did not have any further contact with the corporation's representative prior to the issuance of the Notice of Determination.

31. At no point after receiving the work papers and the related proposed audit changes, did either Mr. Adelman or the corporation's earlier representative, Mr. Goldstein, claim that the food and beverage items sold by Snnacks on the date of the observation differed from those food and beverage items sold by it during the audit period.

32. Mr. Frank, on behalf of RYKG and as a responsible person of RYKG, executed a series of consents allowing the Division to assess tax for the period September 1, 1998 through May 31, 2000 at any time on or before June 20, 2003.

33. On May 5, 2003, the Division issued to RYKG, Inc., a Notice of Determination (Notice No. L-022327889-5) for sales and use taxes in the amount of \$62,755.37, plus penalties of \$25,102.15 and interest of \$28,860.91, for a current balance due of \$116,718.43.

On May 27, 2003, the Division also issued to Howard Frank, a Notice of Determination (Notice No. L-022329159-2) for sales and use taxes in the amount of \$62,775.37, plus penalties of \$25,102.15 and interest of \$29,637.12, for a current balance due of \$117,494.64.

34. Each of the statutory notices herein assessed penalties pursuant to Tax Law § 1145(a)(1)(i) and (vi). Both statutory and omnibus penalties were assessed because the additional tax due is more than 25 percent of the audited tax due.

35. RYKG reported gross sales of \$18,640.00, as well as taxable sales in the same amount, on the sales and use tax return that it filed for the quarter ending February 28, 2002.

36. Mr. Frank concedes that he is a responsible officer of RYKG, Inc.

37. On the Federal S-corporation income tax returns that it filed for the years 1998 through 2001, RYKG claimed a deduction for compensation of officers in the amount of \$30,200.00 in the year 1998 and \$31,200.00 in each of the years 1999 through 2001 and a deduction for salaries and wages (less employment credits) in the amount of \$9,101.00, \$19,467.00, \$18,643.00 and \$27,187.00 in the years 1998 through 2001, respectively. On these same corporate income tax returns, RYKG reported a deduction for rents in the amount of \$74,627.00, \$47,410.00, \$54,762.00 and \$74,627.00 in the years 1998 through 2001, respectively.

38. The corporation did not maintain a general ledger, a cash receipts book or a cash disbursements book. It also did not retain any cash register tapes. Each of Snnacks' cash registers generated only a journal, not a receipt tape. These journals recorded the amount of the sales only, not a listing of each specific item sold. Even though the cash registers were closed out at the end of each work day, no record of the daily sales activity was retained or recorded in a day book. When a journal tape ran out, it was usually thrown away. The corporation did not keep a detailed record of specific items actually sold by Snnacks during the audit period.

39. During the audit period, when product orders were delivered by the vendors, cash was taken out of a cash register to pay for the deliveries. The corporation retained product purchase invoices. Some of the invoices were kept at the kiosk and some were kept by both Mr. Frank and his father. None of the purchase invoices were provided to Mr. McCann prior to the issuance of the Notice of Determination. On limited occasions during the audit period, either

Mr. Frank or his father would purchase mustard, ketchup or rolls at a grocery store, to supplement the purchases from the vendors. Although some receipts for grocery store purchases were kept, they were so faded that they were impossible to read. No grocery store receipts for purchases were provided to the auditor prior to the issuance of the notices of determination.

40. Until January 2000, Snnacks gave mall employees a 25% mall employee discount on their food and beverage purchases. Snnacks did not keep any record of the amounts of mall employee discounted sales that it made.

41. Petitioners submitted into evidence a copy of the Plainview Public School Calendar for the 2001 through 2002 school year obtained from the Plainview school system website.

42. The first store to open in the Sunrise Mall food court was a Wendy's, which opened in September 2002. In November 2002, Sbarro and Bourbon Street Café opened and in December 2002, Master Wok, Taco Bell and Nathan's opened.

43. Sometime in late 2003 Snnacks ceased conducting business, the exact date of its closure is not part of the record. In or about December 2003, the Division commenced a sales tax reaudit of RYKG for the period June 1, 2001 through November 30, 2003.

44. The record includes summary data on the Sunrise Mall vehicle traffic volume counts for the seven-day period June 6, 2004 through June 12, 2004 conducted by a traffic and parking consulting firm for the Sunrise Mall. A review of this summary data indicates that a total of 15,940 vehicles entered the mall driveway on Friday, June 11, 2004 and a total of 95,677 vehicles entered the mall driveway during that 7-day period. Further review of this summary data indicates that traffic volume on Friday, June 11, 2004, accounted for 16.67% of the total traffic volume for the week.

45. Howard and Pamela Frank have two children, a daughter, Chloe, born on June 2, 1996 and a son, Robert, born on October 18, 1999. In January 1998, at 19 months of age, Chloe was diagnosed with autistic disorder. At that time, Chloe began receiving speech and occupational therapy and early learning special education at home and school. Chloe's parents and grandparents actively participated in her treatment and education. In February 2001, at 15 months of age, Robert began speech therapy. Sadly, in June 2001, at 20 months of age, Robert was diagnosed with an autistic spectrum disorder, and he immediately began receiving speech therapy and early learning special education. His parents and grandparents also actively participated in Robert's treatment and education. Both Chloe and Robert continue to receive therapy and special education for their developmental disabilities. Mr. and Mrs. Frank continue to devote their attention to their children's developmental needs.

CONCLUSIONS OF LAW

A. Tax Law § 1135(a)(1) provides that:

[e]very person required to collect tax shall keep records of every sale . . . and of all amounts paid, charged or due thereon and of the tax payable thereon, in such form as the commissioner of taxation and finance may by regulation require. Such records shall include a true copy of each sales slip, invoice, receipt, statement or memorandum upon which subdivision (a) of section eleven hundred thirty-two requires that the tax be stated separately.

The sales records required to be maintained include, among other things, sales slips, invoices, receipts, statements or other memoranda of sale, guest checks, cash register tapes and any other original sales documents (*see*, 20 NYCRR 533.2[b][1]). When no written document is given to the customer, the seller is required to keep a daily record of all cash and credit sales in a day book or similar book (20 NYCRR 533.2[b][1]).

B. Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, “or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined

[by the Division of Taxation] from such information as may be available. If necessary, the tax may be estimated on the basis of external indices. . . .” (Tax Law § 1138[a][1].) When acting pursuant to section 1138(a)(1), the Division is required to select a method reasonably calculated to reflect the tax due. The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of the assessment was erroneous (*see, Matter of Your Own Choice, Inc.*, Tax Appeals Tribunal, February 20, 2003).

C. The standard for reviewing a sales tax audit where external indices were employed was set forth in *Matter of Your Own Choice, Inc.* (Tax Appeals Tribunal, February 20, 2003), as follows:

To determine the adequacy of a taxpayer’s records, the Division must first request (*Matter of Christ Cella, Inc. v. State Tax Commn.*, [102 AD2d 352, 477 NYS2d 858] *supra*) and thoroughly examine (*Matter of King Crab Rest. v. Chu*, 134 AD2d 51, 522 NYS2d 978) the taxpayer’s books and records for the entire period of the proposed assessment (*Matter of Adamides v. Chu*, 134 AD2d 776, 521 NYS2d 826, *lv denied* 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (*Matter of Giordano v. State Tax Commn.*, 145 AD2d 726, 535 NYS2d 255; *Matter of Urban Liqs. v. State Tax Commn.*, 90 AD2d 576, 456 NYS2d 138; *Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; *see also, Matter of Hennekens v. State Tax Commn.*, 114 AD2d 599, 494 NYS2d 208), that they are, in fact, so insufficient that it is ‘virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit’ (*Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43; *Matter of Christ Cella, Inc. v. State Tax Commn.*, *supra*), ‘from which the exact amount of tax due can be determined’ (*Matter of Mohawk Airlines v. Tully*, 75 AD2d 249, 429 NYS2d 759, 760).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (*Matter of Urban Liqs. v. State Tax Commn.*, *supra*). The estimate methodology utilized must be reasonably calculated to reflect taxes due (*Matter of W. T. Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869, 2 L Ed 2d 75), but exactness in the outcome of the audit method is not required (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454; *Matter of Cinelli*, Tax Appeals

Tribunal, September 14, 1989). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (*Matter of Scarpulla v. State Tax Commn.*, 120 AD2d 842, 502 NYS2d 113) or that the audit methodology is unreasonable (*Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451; *Matter of Cousins Serv. Station*, Tax Appeals Tribunal, August 11, 1988). In addition, '[c]onsiderable latitude is given an auditor's method of estimating sales under such circumstances as exist in [each] case' (*Matter of Grecian Sq. v. New York State Tax Commn.*, 119 AD2d 948, 501 NYS2d 219, 221).

D. The original appointment letter sent by the Division to RYKG constituted an adequate request for books and records and covered the entire audit period currently at issue. The corporation provided copies of sales tax returns for the audit period, Federal income tax returns for the years 1998 through 2000, monthly bank statements for the entire audit period and a two-page summary of alleged product purchases for the audit period. A reconciliation performed by the auditor indicated that the sales reported on the corporation's Federal income tax returns were higher than the sales reported on the corporation's sales tax returns. After reviewing the monthly bank statements for the entire audit period, the auditor determined that the bank deposits were simply the amount of money deposited into the account and these bank deposits had no correlation to sales. Although two cash registers recorded Snnnacks' daily business activity, cash register tapes, guest checks and day books were not supplied to the auditor. Indeed, the corporation's original accountant advised the auditor that the corporation did not maintain a sales or cash receipts journal, cash register tapes or a day book. In addition, no purchase invoices were supplied to the auditor. Rather, only a two-page summary of alleged product purchases was supplied. Since product purchases were paid for in cash and only summary product purchase information was provided to him, the auditor was unable to account for either all of the corporation's suppliers or all of its food and beverage purchases during the audit period. The failure to maintain or make available cash register tapes and day books and the lack of guest

checks and purchase invoices clearly establishes that the auditor correctly concluded that the source documentation provided by the corporation for its sales was inadequate. Petitioners have not asserted that the Division did not make an adequate request for books and records or that they submitted adequate books and records to the Division. Since the books and records provided by RYKG were clearly not adequate to substantiate its reported sales, the Division was justified in estimating the corporation's sales tax liability using indirect audit methodologies in this case.

The courts have upheld the use of observation tests on numerous occasions (*see, Matter of Del's Mini Deli, Inc. v. Commissioner of Taxation and Finance*, 205 AD2d 989, 613 NYS2d 967; *Matter of Sarantopoulos v. Tax Appeals Tribunal*, 186 AD2d 878, 522 NYS2d 102; *Matter of Vebol Edibles v. Tax Appeals Tribunal*, 162 AD2d 765, 577 NYS2d 678, *lv denied* 77 NY2d 803, 567 NYS2d 643; *Matter of Club Marakesh v. State Tax Commission*, 151 AD2d 908, 542 NYS2d 881, *lv denied* 74 NY2d 616, 550 NYS2d 276; and *Matter of Meskouris Bros., Inc. v. Chu*, 139 AD2d 813, 526 NYS2d 679). Furthermore, it is reasonable to extrapolate the results of a one-day test over a multi-year audit period. (*See, Matter of Del's Mini Deli, Inc. v. Commissioner of Taxation and Finance, supra*; *Matter of Lombard v. Commr. of Taxation and Finance*, 197 AD2d 799, 602 NYS2d 972; *Matter of Marte*, Tax Appeals Tribunal, August 5, 2004; *Matter of Himed Deli Corp.*, Tax Appeals Tribunal, March 30, 2000.)

E. Where, as in the instant matter, resort to an observation test audit is appropriate, the burden of proof lies with the taxpayer to show by clear and convincing evidence that the audit method was unreasonable or that the results were unreasonably inaccurate (*see, Matter of Meskouris Bros. v. Chu, supra*; *Matter of Surface Line Operators Fraternal Org. v. Tully, supra*).

F. Petitioners contend that the Division's audit methodology was flawed for a number of reasons. First, petitioners contend that the business that Mr. McCann and the other auditors observed on April 26, 2002 did not even remotely resemble the business that existed during the audit period. Pointing to the audit log entry for September 5, 2001, petitioners claim that Mr. McCann was told that Snnacks was a simple snack stand with limited items for sale during the audit period, specifically pretzels, hot dogs and soda. They further claim that in 1998, soda was the biggest dollar volume item sold by Snnacks. They assert that sometime in 2001, Snnacks began offering more items for sale and that by the date of the observation test, it offered many items for sale. In support of their contention that food and beverage items available for sale on the date of the observation test differed from the food and beverage items available for sale during the audit period, petitioners submitted five printed menus that allegedly set forth the prices of items available for sale at Snnacks during the years 1998 through 2002. Petitioners aver that during the entire audit period, Snnacks maintained and made available to its customers these printed menus that clearly identified the nature of the products sold and the prices for which they were sold. Petitioners further aver that Mr. McCann did not ask for, and did not use, the printed menus that existed during the audit period.

Petitioners have failed to prove that the auditors observed a totally different business on April 26, 2002 than existed during the audit period. The record does not support petitioners' claim that the auditor was informed that Snnacks offered only three items for sale during the audit period. My review of the audit log entry for September 5, 2001 clearly indicates that Snnacks offered more than the three specifically identified items for sale during the audit period. In support of their claim that soda was the biggest volume item sold by Snnacks in 1998, petitioners presented the testimony of Mr. Frank. I find Mr. Frank's testimony to be

extremely vague. Since he admitted that Snnacks did not keep any record of the specific amount of each item that it sold during the audit period or a day book of its daily sales during the audit period, he was unable to quantify the amount of soda sales made by Snnacks in 1998. In response to the Division's written request for books and records pertaining to its sales tax liability for the period at issue, the corporation's first representative supplied the auditor with copies of the corporation's Federal income tax returns for the years 1998 through 2000, sales and use tax returns and monthly bank statements for the audit period, as well as a two-page summary of alleged product purchases made during the audit period. The documentation provided to the auditor contained limited information about either the items available for sale during the audit period or the items actually sold during the audit period. While sales were reported on both the corporation's Federal income tax returns and sales and use tax returns, neither the Federal income tax returns nor the sales and use tax returns identified the specific items sold by Snnacks during the audit period. The corporation did not supply the auditor with cash register tapes, guest checks or day books for the audit period. Nor did it supply the auditor with a detailed list of the specific items actually sold by Snnacks during the audit period. The two-page summary of alleged product purchases listed a total of eight products and suppliers, their alleged respective dollar amounts and the alleged total product purchase amounts during the audit period. Although the original representative claimed that the information set forth in the two-page summary was taken from purchase invoices dated within the audit period, none of these purchase invoices were provided to the auditor prior to the issuance of the notices of determination. With respect to the printed menus that petitioners assert existed during the audit period and on the date of the observation test, Mr. McCann credibly testified that he did not see a printed menu on the date of the observation test. Rather, he observed a menu board located

within the kiosk from which Snnacks' customers ordered. Furthermore, Mr. McCann credibly testified that it was his experience that snack stands such as Snnacks listed the items available for sale on a menu board, not in printed menus. It is noted that on the date of the observation test, neither Mr. Frank, who was present at Snnacks for a short period of time during the afternoon, nor any of Snnacks' employees working that day supplied Mr. McCann with a printed menu allegedly available to customers at that time. Indeed, during the course of the audit, the corporation did not provide Mr. McCann with any printed menus listing the sales prices of the food and beverage items available for sale at Snnacks during the period September 1, 1998 through May 31, 2001. Furthermore, at no point after receiving the work papers and the related proposed audit changes, did either the original representative, Mr. Goldstein, or the subsequent representative, Mr. Adelman, claim that the food and beverage items sold by Snnacks on the date of the observation differed from those food and beverage items sold by it during the audit period.

Second, petitioners claim that although he was aware of the construction taking place within the Sunrise Mall on the date of the observation test, the auditor failed to consider the impact of such construction on the corporation's sales. They maintain that sales were greater on the observation date than they were during the audit period because many of the construction workers working on the mall's new food court purchased items at Snnacks on that day, April 26, 2002. Petitioners' claim is without merit. Although two cash registers were used to record the corporation's daily sales activity, the auditor was not provided with the cash register tapes for either the date of the observation test or the entire audit period. In fact, the corporation did not provide the auditor with any source documentation pertaining to the corporation's sales for the audit period, such as, cash register tapes, guest checks or day books. Therefore, the auditor

was unable to ascertain Snnacks' daily sales activity during the audit period, compare it to the sales activity on the observation date and make any adjustments in the observation date sales that might have been warranted. Furthermore, since the record does not include any source documentation concerning Snnacks' sales activity for the audit period, it is impossible to determine if there is any validity to petitioners' argument.

Third, petitioners claim that the auditor failed to inquire about the competitors that existed during the audit period at issue but not on the date of the observation test. They assert that Snnacks had significant competition, including a yogurt store, a Roy Rogers restaurant, a Nathan's, another snack stand, a deli and a coffee stand, located near its kiosk, selling identical and similar items. Petitioners further assert that, as of the date of the observation test, each of the foregoing competitors was no longer in business and Snnacks was the only entity serving food products in the mall. Petitioners' claims are without merit. At no point during the audit, did the corporation supply the auditor with any source documentation, i.e., cash register receipts, guest checks or day books, concerning the corporation's sales during the audit period. There is also no evidence that either the original representative or the subsequent representative ever claimed that sales observed on the date of the observation test were greater than they would have been during the audit period because the corporation's competitors had gone out of business. In addition, the auditor credibly testified that a McDonald's and a concession selling pizza were also located in the Sunrise Mall on the date of the observation test. It is noted that the corporation did not report a greater amount of taxable sales in the quarter ending February 28, 2002 (the quarter just before the date of the observation test) than it had in each of the quarters of the audit period. While there is evidence that three of Snnacks' competitors did in fact go out of business during the audit period, the impact of such closings cannot be determined because

petitioners have failed to present any source documentation (cash register tapes, guest checks or day books) concerning the corporation's sales activity during the audit period.

In sum, petitioners have failed to show by clear and convincing evidence that the audit method employed by the Division was unreasonable (*see, Matter of Meskouris Bros. v. Chu, supra; Matter of Surface Line Operators Fraternal Org. v. Tully, supra*).

G. Petitioners also attack the assumptions and calculations made by the auditor in conducting the audit. They assert that the auditor did not take certain factors into account when he estimated the tax liability and, therefore, the audit method utilized by the Division is flawed. Petitioners claim that in making his determination of taxable sales for the observation date, the auditor failed to take into account that sales were greater than usual at Snnacks on the observation date for a number of reasons. First, petitioners contend that the auditor failed to take into consideration that the observation date was a Friday, traditionally the second busiest day at the Sunrise Mall. It is clear from the record that the auditor did take into consideration that the observation test was being conducted on a Friday. Mr. McCann testified that in order to give weight to Friday being a busy day, he examined the sales from a prior audit of a similar fast food business, located at the Broadway Mall in Hicksville, New York, that he had conducted in May 2001. Based on his review of the information from that prior audit, Mr. McCann determined the estimated ratio of Friday's sales to total weekly sales to be 16.12%. It is well established that an auditor's experience is a rational basis for estimating taxable sales (*see, Matter of Oak Beach Inn Corp. v. Wexler*, 158 AD2d 785, 551 NYS2d 375; *Matter of Hanratty's/732 Amsterdam Tavern v. New York State Commn.*, 88 AD2d 1028, 451 NYS2d 900, *appeal dismissed* 57 NY2d 954, 457 NYS2d 1028). It is also noted that an analysis of the summary data on the Sunrise Mall traffic volume counts for the 7-day period June 6, 2003 through June 13, 2004,

submitted by petitioners, indicates that Friday's traffic volume accounted for 16.67% of the total traffic volume for the week. This analysis confirms that the auditor's determination of the estimated ratio of Friday sales was reasonable. Second, they assert that the observation date was a Mother's Day Sale preview day at the mall and therefore more people were in the mall. Petitioners have failed to submit any evidence that the Sunrise Mall was having a Mother's Day Sale preview day on April 26, 2002, a date that was two weeks before Mother's Day, May 12, 2002. Third, they maintain that the observation date, Friday, April 26, 2002, was the day after a significant rainfall. Petitioner aver that more shoppers go to the mall during the day following a day of inclement weather. While petitioners did submit evidence which indicates that the Massapequa and Farmingdale areas experienced rain, heavy at times, and gusting winds on Thursday, April 25, 2002, they submitted absolutely no evidence to support Mr. Frank's testimony that more shoppers go to the mall during the day that follows a day of inclement weather. Lastly, they claim that the observation date was an excess school "snow day," in effect, a school holiday and, therefore, there were many school children in the mall. They point out that the Plainview Public School Calendar for the 2001 through 2002 school year clearly shows that Friday, April 26, 2002 was a school holiday because the Plainview School District needed to use an excess snow day. I have carefully reviewed the Plainview School Calendar that is part of the record, including the web address listed at the bottom of the page, and it is clear that this calendar relates to the Plainview School District located in Oklahoma, not a school district located on Long Island, New York. Petitioners have failed to prove that any of the school districts located on Long Island near the Sunrise Mall in fact had a school holiday on Friday, April 26, 2002.

Petitioners also claim that the auditor used a faulty, simplistic Bureau of Labor inflation analysis in determining audited quarterly sales rather than employing the actual rate of inflation of prices charged by Snnacks. They maintain that the analysis, done by their expert, Mr. Stone, of the selling prices of eight items available for sale at Snnacks during the years 1998 through 2002 clearly establishes that the rate of inflation was almost 30% as opposed to the 2.5% inflation rate determined by the auditor. To account for the fact that the observation took place on April 26, 2002 and the audit period ended on May 31, 2001, the auditor used the Bureau of Labor Statistics Data Consumer Price Index for food and beverages to adjust the quarterly taxable sales for inflation. This adjustment was reflected in work papers given to the corporation's original representative and its subsequent representative. The corporation did not provide any purchase invoices for the audit period, any source documentation pertaining to sales during the audit period or printed menus to the auditor prior to the issuance of the notices at issue. In doing his analysis, Mr. Stone used the selling prices of the eight items obtained from five printed menus supplied to him by petitioners shortly before the hearing. While petitioners assert that the prices listed on these printed menus were the prices actually charged, they have provided absolutely no evidence to prove this assertion. Without cash register tapes, guest checks, or any other source documentation for sales, it is impossible to determine what was being sold, how much was being sold, and how much was being paid for each item during the audit period. Therefore, I do not find that any further adjustment for inflation is warranted. Lastly, petitioners contend that the auditor failed to consider that during the audit period, 25% of the corporation's sales were impacted by a 25% mall employee discount, which discount was not given on sales to mall employees on the observation date. While the affidavits of three Sunrise Mall employees establish that Snnacks did indeed give a 25% discount on purchases made by

mall employees until January 2000, there is no documentary evidence to support Mr. Frank's testimony that discounted sales made to mall employees accounted for 25% of Snnacks' sales during the audit period. Indeed, Mr. Frank admitted that the corporation did not keep any record of the amount of sales made by Snnacks during the audit period or the amount of discounted sales made to mall employees from September 1, 1998 until January 2000.

H. The determination of whether the method chosen by the Division was reasonable is based upon the information available to the Division at the time of the issuance of the notice (*see, Matter of Continental Arms Corp. v. State Tax Commn.*, 72 NY2d 976, 534 NYS2d 362; *Matter of Northern States Contracting Co.*, Tax Appeals Tribunal, February 6, 1992). The record establishes that, after reviewing the books and records and determining they were inadequate, the Division concluded that a one-day observation test of the corporation's sales activity was necessary. After conferring with his team leader and section heads, the auditor selected Friday, April 26, 2002, as the date for the unannounced one-day observation test. The observation test and the auditor's original audit adjustments are noted in Findings of Fact "16" through "24." The record reflects that even though he disagreed with the proposed audit change, the corporation's original representative cancelled two scheduled conferences to discuss the audit findings. It further reflects that, on November 22, 2002, the auditor, his team leader and the corporation's subsequent representative, Mr. Adelman, had a conference at which the audit findings and the basis of the audit findings were discussed. As a result of that conference and his audit experience, the auditor revised his audit computations of the additional tax liability as noted in Finding of Fact "28." The record further reflects the efforts that the auditor made to discuss his revised audit findings with Mr. Adelman from the date that the two statements of proposed audit change were issued on December 10, 2002 through May 5, 2003, the date of

issuance of the Notice of Determination to the corporation. Mr. Adelman did not make any comments about, or supply the auditor with any documentation pertaining to, either the corporation's daily sales activity for the audit period or the auditor's estimate of these sales at any time prior to the issuance of the Notice of Determination on May 5, 2003. Based upon the information available to the Division at the time the notice was issued, I find that audit method utilized was reasonable (*Matter of Continental Arms Corp. v. State Tax Commn., supra; see also, Matter of Northern States Contracting Co., supra*).

I. In their brief, petitioners claim that Mr. Stone, a CPA hired by RYKG to help assist its current representative resolve a subsequent audit, performed a reasonable audit reconstruction of the corporation's tax liability for the period September 1, 1998 through May 31, 2001. Petitioners contend that Mr. Stone used all of the purchase invoices provided by Mr. Frank, which consisted of over 99% of the invoices for the audit period and performed a detailed and conservative markup (purchase) analysis to determine the appropriate amount of RYKG's tax liability for the audit period at issue. They maintain that these purchase invoices were verified as complete by third-party contact undertaken by Mr. Stone. Petitioners assert that, in order to be conservative based upon the information available to him, Mr. Stone did not make any adjustments to his computations for waste, theft, lost goods or discounts. They further assert that Mr. Stone also did not consider any nontaxable sales, but concluded that all sales were taxable in his analysis. According to Mr. Stone's computations, RYKG owed additional sales tax in the amount of \$14,619.00 on unreported taxable sales for the period September 1, 1998 through May 31, 2001. Petitioners argue that, inasmuch as the purchase invoices for the audit period were given to the Division "during the continuation of the examination of the petitioners," a markup (purchase) analysis, a more accurate method to determine petitioners' tax liabilities, could have,

and should have, been undertaken by the Division. In their brief, petitioners submit that RYKG owes additional sales tax in the amount of \$14,619.00 for the period September 1, 1998 through May 31, 2001, the amount of additional sales tax that Mr. Stone determined was due based upon his markup analysis.

J. Turning first to petitioners' argument that the Division's use of a markup (purchase) analysis would have yielded more accurate results, it has no merit. A taxpayer cannot meet his obligation to prove by clear and convincing evidence that an audit method was unreasonable or the results inaccurate merely by arguing that a different method would have yielded more accurate results (*see, Matter of Scholastic Specialty Corp. v. Tax Appeals Tribunal*, 198 AD2d 684, 603 NYS2d 357, *lv denied* 83 NY2d 751, 611 NYS2d 133; *Matter of Shukry v. Tax Appeals Tribunal*, 184 AD2d 874, 585 NYS2d 531). The record clearly establishes that the corporation failed to provide the auditor with purchase invoices, cash register tapes, guest checks, day books or any other source documentation concerning sales for the audit period at any time prior to the issuance of the notices of determination. Given the corporation's failure to supply adequate books and records or information concerning its operation during the audit, the Division was entitled to rely on its own audit experience in its estimation process (*Matter of Convissar v. State Tax Commn.*, 69 AD2d 929, 415 NYS2d 305; *Matter of Giordano v. State Tax Commn.*, *supra*). With respect to Mr. Stone's markup (purchase) analysis, it was based upon records and information supplied by Mr. Frank. The records consisted of allegedly almost all of the purchase invoices for the audit period and printed menus allegedly used by Snnacks in the years 1998 through 2002. The information supplied by Mr. Frank pertained to the third-party verification of the purchase invoices, the serving sizes of various items allegedly sold by Snnacks and the number of servings the corporation was allegedly able to get from a particular

product. I do not find the source documents and the information used by Mr. Stone in his analysis or his analysis to be reliable. The record clearly establishes that, during the audit period, product purchases were paid for by cash taken from the register. Therefore, it is impossible to verify that these purchase invoices actually represent all of the purchases made by the corporation during that period. In addition, Mr. Frank not only supplied the purchase invoices to Mr. Stone, he also undertook the third-party verification of those same purchase invoices. Given the absence of cash register tapes, guest checks or other source documentation for sales, it is impossible to determine whether the prices listed on the printed menus were consistent with the prices that Snnacks actually charged for the items available for sale during the audit period. It is also impossible to determine whether the items listed on the alleged menus were actually being sold. Additionally, without cash register tapes, guest checks or other source documentation for sales, I am unable verify the accuracy of Mr. Stone's computations. Petitioners have failed to prove by clear and convincing evidence that the amount assessed is erroneous (*Matter of Surface Line Operators Fraternal Org. v. Tully, supra*). Any imprecision in the audit results is the direct result of the corporation's failure to keep and maintain records of all of its sales as required by Tax Law § 1135(a)(1) (*Matter of Markowitz v. State Tax Commission, supra*).

K. Penalties were imposed pursuant to Tax Law § 1145(a)(1)(i) which authorizes the imposition of penalties for failure to pay any tax imposed under Articles 28 and 29 of the Tax Law. Tax Law § 1145(a)(1)(iii) provides that if the failure or delay was due to reasonable cause and not due to willful neglect, penalty and additional interest shall be remitted.

Petitioners contend that the penalties should be abated because of Mr. Frank's extended absence from his place of business. They assert that due to the disabilities of Mr. Frank's two

young children and the requirement that he fully attend to their needs, his extended absence from Snnacks was unavoidable.

Although I do not doubt that the developmental needs of Mr. Frank's children may have caused his extended absence from Snnacks, I find that the Division properly assessed penalties in this matter. The record clearly establishes that Mr. Frank had an extensive business background, including ownership of a deli before the purchase of Snnacks. However, despite his substantial business experience, the corporation did not maintain a general ledger, a cash receipts book or a cash disbursements book. The corporation also did not retain any cash register tapes from its two operating cash registers. Indeed, Mr. Frank testified that even though the cash registers were closed out at the end of each work day, no record of the snack stand's daily sales activity was retained or recorded in a day book. Clearly, the corporation was unable to ascertain its proper tax liability for the audit period because no effort was made to maintain adequate records of the snack stand's sales (*see*, 20 NYCRR former 536.5[d][2]). Penalties are also appropriate in this case because of the substantial discrepancy between the amount of the reported taxable sales and the amount of tax determined on audit (*see, Matter of S.B.H. Super Markets v. Chu*, 135 AD2d 1048, 522 NYS2d 985; *Matter of Himed Deli Corp.*, Tax Appeals Tribunal, March 20, 2000).

Petitioners have also been assessed penalty pursuant to Tax Law § 1145(a)(1)(vi) for omission of greater than 25 percent of the tax due. Since the initial issue of penalties assessed pursuant to Tax Law § 1145(a)(1)(i) has been determined against petitioners, this additional penalty must also be sustained in the absence of a showing of reasonable cause.

L. The petition of RYKG, Inc. is denied and the Notice of Determination dated May 5, 2003 is sustained. The petition of Howard Frank is denied and the Notice of Determination dated May 27, 2003 is sustained.

DATED: Troy, New York
January 12, 2006

/s/ Winifred M. Maloney
ADMINISTRATIVE LAW JUDGE